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United Kingdom: Labor Party Struggles with
Economic Platform

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Summary

Britain's Labor Party leaders are trying to formulate a credible set of economic policies to convince voters that Labor is a viable alternative to the Tories in the next national election, due by June 1988. Their platform, though still incomplete, contains proposals that are little more than rehashed industrial policies from the 1960s and 1970s--calling most notably for another effort to revive aging industry, a major role for the government in choosing investment projects, and the imposition of exchange controls. We expect the Labor Party to both firm up and moderate its domestic platform by the fall party conference in order to allow sufficient time for a strong appeal to the public. A Labor government would not necessitate any fundamental changes in Britain's economic relations with the United States, but it would introduce greater tension in negotiations on specific trade issues and install leaders whose philosophy on government's role in the economy differs sharply from that of Washington.

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This memorandum was prepared by Office of European Analysis. Questions and comments are welcome and may be addressed to Chief, West European Division,

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The Political Setting

The British Labor Party is starting to prepare in earnest for the next national election, which must be held by the spring of 1988, but could be called as early as spring 1987. Labor leader Neil Kinnock and his chief economic adviser Roy Hattersley have told US officials that a credible set of economic proposals to bring down the country's severe unemployment and provide better overall direction to Britain's economic future is essential to Labor's winning the next election. Labor leaders also hope that an economic platform eschewing leftist demands for massive renationalization and uncontrolled reflation will win over some reluctant voters who are uncomfortable with the Party's radical defense policies. Recent polls taken even in the immediate aftermath of the Westland helicopter fiasco--Prime Minister Thatcher's worst political crisis since taking office--indicate that Kinnock is fighting an uphill battle. Labor's best showing among the various polls was only 37 percent, still short of the 40 percent generally considered necessary for a Parliamentary majority. Moreover, polls still consistently rank the Tory Party as more capable of managing the economy.

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The Platform So Far

Although Labor's program is still in the formative stages, we can identify several aspects that are unlikely to change much in the party's next election manifesto. Many of the measures call for a reversal in important parts of Thatcher's market-oriented approach to the economy:

- Industrial and Employment Policies. Labor's major campaign theme is that it is "The Party of Production". A new government-sponsored Enterprise Board would be tasked with restructuring British manufacturing to fill the void that will be created by the decline in North Sea oil in the 1990s, keep the current account in surplus, and solve the unemployment problem. Labor's announced goal is to create 1 million new jobs in the first two years of assuming office; party leaders project that 400,000 new jobs would result from increased government spending on infrastructure, particularly on roads and inner-city housing, and the remaining 600,000 from the expansion of the manufacturing sector that would result from lending by a new National Investment Bank (NIB).
- Exchange Controls. Funding for the NIB would be provided, at least initially, from the forced repatriation of British

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private sector funds--perhaps as much as \$30 billion--that have been invested abroad since Thatcher abolished controls on overseas investment in 1979. Claiming that Britain's financial markets have starved domestic industry of investment, Labor would impose heavy tax penalties on pension funds and other pooled investment schemes that have foreign holdings in excess of 5 percent of their total assets. Shadow Chancellor of the Exchequer Hattersley argues that another benefit of forced repatriation of capital to Britain would be to prevent speculation against sterling when the Labor government takes over and enable the government to avoid a policy of high interest rates.

--Fiscal Policy. Labor proposes to stop immediately all sales of public assets, raise income taxes on the very rich--those earning four or five times the national average--and increase government spending (by an unspecified amount) on infrastructure and industrial support programs. Labor plans to do all this--while making no cuts in welfare spending--without "running up a Reagan-style deficit." [REDACTED]

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At the same time that Kinnock is calling for a selective reversal of many of Thatcher's macroeconomic policies, he has said he recognizes that Labor cannot completely return Britain to the pre-Thatcher era. Kinnock has abandoned several issues that were prominent in Labor's 1983 election campaign, including calls for the immediate renationalization of all industries Thatcher privatized and the withdrawal of Britain from the EC. Even more vexing to the far left wing of the Party is Kinnock's decision not to repeal all of Thatcher's 1982-1984 trade union reform legislation--especially provisions that permit unions to accept state aid for holding secret ballots--or the sale of public housing to tenants. [REDACTED]

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Is "Labor Economics" Credible?

In our view, Labor still has a good deal of work to complete before it can expect to win voters over by virtue of its economic program. The proposals presented to date do not yet comprise a cohesive strategy and in some respects seem contradictory. Many of the policies are little more than a rehashing of methods tried by previous Labor governments in the 1960s and 1970s that were of doubtful efficacy at the time and are probably outdated now. Labor's industrial policies in particular still have a familiar Socialist ring to them--calling for excessive government intervention in investment and production decisions--that opinion

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polls show are unlikely to appeal to voters outside the party's traditional core of support. The financial press ridicules the concept of the NIB and Labor's plans to reimpose exchange controls. The press questions how a staff of government bureaucrats can identify viable projects faster than private firms such as Barclays, Citibank, or Prudential and points out the absurdity of restricting investment to domestic markets in an era of highly integrated international capital markets. A widescale forced repatriation of capital would also cause a deterioration in Britain's current account, which has benefited greatly in recent years from increased earnings on overseas portfolio investment.

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Voters, remembering their last taste of double-digit inflation and crippling strikes, almost certainly will worry about the potential of Labor's policies for igniting a new round of inflationary pressure. The extra government spending earmarked for job creation and intentions to abandon new asset sales would increase the government deficit by several billion dollars, which we do not believe can be made up by increased taxes on the rich. Labor has not presented a convincing plan for controlling wages and prices but instead plans to rely on a system of yearly tripartite summits with the unions and business. Leaders of Britain's major unions continue to denounce any formal controls on wage settlements, and we doubt the unions will be more willing to cooperate on a longterm incomes policy now than they have for the past 20 years.

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The platform, as it currently stands, raises other unanswered questions about Labor's economic intentions. It is vague as to where new jobs will come from, implying that a fair percentage will be in already decaying, obsolete industries. Efforts to maintain obsolete plants, in our view, are more likely to slow the difficult process of structural adjustment to a more modern industrial economy. Labor spokesmen also have talked in general terms of regional development programs without spelling out their content, and with the exception of exchange controls the party has not clearly laid out plans for any monetary policy to accompany budget plans.

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Outlook

Labor has a lot of work to do in the months before next fall's annual party conference to clarify the specifics of its economic program and sell its ideas to a skeptical public before the election due by June 1988. US Embassy officers have been impressed favorably by many of Kinnock's staff members and

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research economists and believe they can develop a credible blend of proposals. Labor strategists will try to capitalize on any bad economic news over the next months and will attack sharply actions Thatcher takes that can be construed as hurting the middle class. We expect Labor to concentrate attacks on cutbacks in the welfare state or Tory plans to revamp the tax system.

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We expect Labor to continue to moderate the tone of the economic platform and make alternative policies seem more realistic to the media and other critics who in the past have charged the party with "promising all things to all Socialists." We have already seen several examples of this process in recent weeks, including Hattersley's warning in an interview in the Financial Times, that when Labor gains control of government it will have only limited scope for quick changes in the economy, and assurances from him that restraining inflation will remain a primary consideration. A campaign pamphlet on plans for dealing with unemployment goes so far as to cite the mistakes of the 1981-82 Mitterrand policies in France--which are generally recognized now as having been overly expansionary--as an example of how not to go about managing the economy.

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Party leader Kinnock is also seeking to broaden Labor's appeal beyond committed Socialists by stressing that his first priority would be increasing production, with redistribution following at a later stage once enough wealth has been generated. He is also calling for consultations with industry leaders to examine a more flexible system of tax incentives for exports, investment promotion, research and development, and the promotion of small firms. Nevertheless, Kinnock will be careful not to appear to be "cozying up to the wealthier classes", something that risks alienating the left and inviting attacks that his policies are indistinguishable either from Thatcher's or the SDP-Liberal Alliance.

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Implications for Economic Relations with the United States

In our judgment, a Labor Party victory in the next British election probably would not portend a fundamental change in the economic relationship between the United States and the United Kingdom. With the exception of the reintroduction of exchange controls--which could considerably reduce British investment in the US, up from \$9.8 billion in 1979 to more than \$38 billion by the end of 1984--none of the economic policies advocated thus far appear to be especially worrisome to US interests. Notwithstanding Labor's heavy emphasis on the need for British

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industry to reassert its place in the world, we do not anticipate any major problems for US and other multinational corporations already operating in Britain. Moreover, London almost certainly would maintain existing membership in the EC, IMF, World Bank, and other major international institutions and would remain a participant in the annual economic summit. [REDACTED]

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US policymakers, however, would probably face tougher negotiations with a Labor government on a wide range of trade issues and could expect less support from Britain in international forums. Labor would, for example, almost certainly adopt an even more protectionist stance than the present Tory leadership on policies such as issuing licenses for oil exploration in the North Sea and might take action to prevent foreign takeover of key British companies. We would also expect somewhat less cooperation with US attempts to impose economic sanctions against third countries or to police COCOM regulations governing Western trade with the Soviet Bloc, particularly in the gray areas, where direct military application is not immediately apparent. Perhaps most damaging, the United States would lose its closest ally in general philosophy about the proper role of government in a national economy and the benefits of a market-oriented approach to economic growth. [REDACTED]

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SUBJECT: UK: Labor Party Struggles with Economic
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